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The October War and Egypt's Economic Prospects

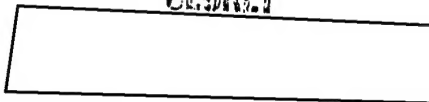
The October war with Israel marked a major turning point in Egypt's recent economic history. Before the war Egypt faced a desperate economic situation. Bereft of many major assets and unable to secure credit in the West, Cairo was dependent on the Soviet Union for arms and on the uncertain charity of its Arab neighbors to maintain the inflow of foreign goods on which urban consumers and the import dependent industrial sector relied.

The economic outlook began to brighten in the Fall of 1973 when more than \$800 million in ad hoc Arab aid was transferred to Egypt. At the same time, the synthetic fibre shortage, a direct result of the war-related energy crisis, drove up prices of Egyptian long staple cotton, more than compensating for the high price of grain and other essential imports. These financial windfalls enabled Egypt to pay most of its overdue debts and to augment its financial reserves by \$200 million, greatly enhancing its credit rating. In the post-war period the consequences of the confrontation

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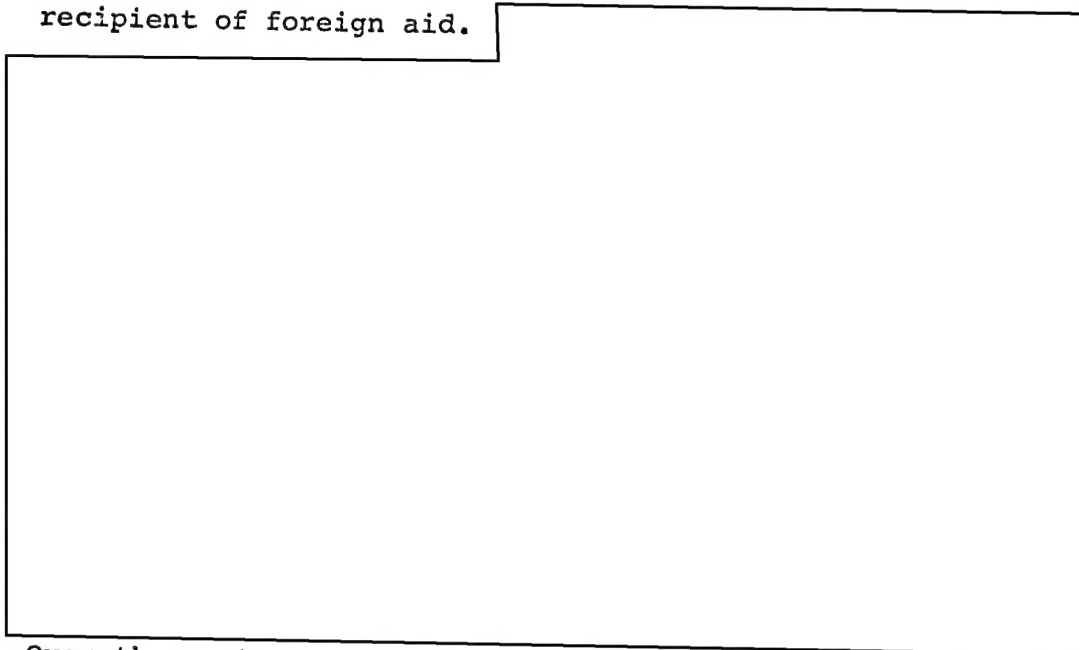


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continue to react favorably, placing Egypt's ambitious economic goals clearly within reach for the first time in more than a decade.

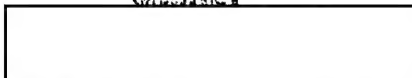
Mainly because of its pivotal position in Arab affairs, Egypt in the post-war era has become a major recipient of foreign aid.

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Over the next several years, aid utilization plus earnings from the canal and the SUMED pipeline should enable Egypt to at least maintain present per capita income levels and service its past debts. Should Egypt regain the Sinai oilfields, a modest increase in the rate of growth almost certainly could be financed with bilateral aid and indigenous resources.

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The war may also have assured Egypt the inflow of foreign equity capital that is needed to rapidly accelerate and restructure economic growth without adding to foreign indebtedness. In 1970 the Sadat regime instituted a program designed to attract foreign capital, encourage repatriation of funds held abroad by Egyptians, and gradually desocialize economic institutions. Before the October war the program was almost impossible to implement, partly because of Sadat's tenuous political position, but mainly because of the economic uncertainty engendered by the constant threat of war. Since the war, Egypt -- with the most advanced economy in the Arab world -- has become a magnet for surplus Arab oil revenues. The smell of Arab money, favorable prospects for peace, and Egypt's greatly improved credit rating are also attracting non-Arab investors in increasing numbers. Already more than \$3 billion in foreign equity capital for investment projects in Egypt is awaiting government approval and new offers are pouring in daily. Over the next decade a capital inflow of this magnitude could triple the investment rate and assure the 7-10% annual growth rate targeted by Egyptian planners.

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Initially this capital will be hard to absorb. The entrenched urban interest groups will cling to the security of the present state economic system which guarantees employment and a minimum level of consumption for all. The government as a result may continue to postpone the needed renovation of the socialist sector, creating a tangle of administrative and jurisdictional problems and greatly reducing the quality of financial and other services available to the private sector. Fear of foreign economic domination also will cause delays as the government seeks financing to enable domestic equity shares in proposed investment projects. Physical bottlenecks, the legacy of irrational investment in the past, may create the most serious problems of all. The port of Alexandria and the outmoded internal transportation and distribution systems are already functioning at capacity levels. Little extra electric power is available. Unless considerable local and foreign resources are earmarked for the economic infrastructure, Egypt's fledgling private sector may founder.

CIA/OER
17 September 1974

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MEMORANDUM FOR: The Record

The attached brief summary of Egypt's post-war economic prospects and potential economic problems was requested by NEA/Egypt (State) for inclusion in a briefing book being prepared at State for Secretary Kissinger's use [redacted]

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18 September 1974
(DATE)

FORM NO. 101 REPLACES FORM 10-101
1 AUG 54 WHICH MAY BE USED.

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